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Internal Audit Services Branch

Audit of Section 33 of the *Financial Administration Act* Phase 1B – Operating Expenditures

February 2014

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Executive Summary

The *Financial Administration Act* (FAA) provides legislative requirements for financial management of the Government of Canada. Section 32 of the FAA pertains to the commitment of funds against an appropriation, Section 34 provides the authority to certify that the goods or services were received and Section 33, the final step in the procure to payment process, provides the authority for issuing the payment.

Pursuant to Section 33 of the FAA, no requisition shall be made for a payment that is not a lawful charge against an appropriation, will result in expenditures exceeding an appropriation, or will result in an insufficient balance in an appropriation to meet the commitments charged against it. Financial officers exercising Section 33 payment authority are also responsible for ensuring that the relevant provisions of the Treasury Board Secretariat (TBS) Directive on Account Verification have been upheld.

Payment transactions are processed by the Chief Financial Officer Branch (CFOB) at National Headquarters (NHQ) and in Regional Offices as well as decentralized responsibility centres in other branches of the Department. The Department's account verification procedures classify expenditures into risk classes and entail different verification procedures for each class of transaction.

No transaction is to be released for payment authorization until it has undergone the required verification procedures. Financial officers exercising Section 33 certification rely on verification completed by financial staff and automated controls in the Corporate Management System (CMS) that batch individual transactions for payment release. Appendix B provides a summary process map of the operating expenditure payment process for the Department.

Audit Objective

The objective of the audit was to provide assurance that operating expenditure practices related to certification under Section 33 are compliant with relevant legislation.

Summary of Key Findings

- Roles, responsibilities and accountabilities for account verification are documented.
- Segregation of duties is working.
- A delegation of financial authority instrument is in place and updated as required.

- Account verification procedures were not consistently applied.
- A risk management model has been developed and efforts are required to further its implementation.
- Controls around the processing of payment batches could be strengthened.

Audit Conclusion

The audit concluded that operating expenditure payment practices related to certification under Section 33 are compliant with relevant legislation. Improvements to controls over processing of payment batches and risk management practices are recommended to fully implement the control framework.

Recommendations

The Chief Financial Officer (CFO) should:

- Monitor the implementation of the risk based sampling methodology to ensure account verification controls for operating expenditures are consistently applied throughout the Department.
- Ensure the risk management model is updated on a timely basis.
- Ensure that automated controls over batch processing are documented and tested, including an audit trail linking individual transactions to batches, in the new financial system.

1.0 Background

1.1 Context

The FAA provides legislative requirements for financial management of the Government of Canada. Section 33 of the FAA governs payments, and the conditions that must be met before payments are issued.

Finance officers exercising payment certification under Section 33 of the FAA are responsible for ensuring that no payment will be issued that is not a lawful charge against an appropriation, will result in expenditures exceeding an appropriation, or will result in an insufficient balance in an appropriation to meet the commitments charged against it. They are also responsible for ensuring that the relevant provisions of the TBS Directive on Account Verification have been upheld. These include ensuring that there is auditable evidence demonstrating that account verification has taken place and has been certified by an individual with delegated financial signing authority pursuant to Section 34 of the FAA. The Directive also requires that:

- all high risk transactions are subjected to a full review; and
- a sample of medium and low risk transactions are selected based on a sample selection methodology and are subjected to a review of the most important aspects of each transaction.

Payment transactions are processed by CFOB at NHQ and in Regional Offices as well as decentralized responsibility centres in other branches of the Department. The Department's account verification procedures classify expenditures into risk classes and entail different verification procedures for each class of transaction.

A four-point check is to be performed by financial clerks that validate Section 34 certifications including accuracy of payee and invoices for all transactions. In addition, a complete pre-payment verification of all high risk transactions is to be performed by a financial officer. The Department has also implemented a Statistical Sampling Methodology in 2012 for post-payment verification.

No transaction is to be released for payment authorization until it has undergone the required verification procedures. Financial officers exercising Section 33 certification rely on verification completed by financial staff and automated controls in CMS that batch individual transactions for payment release. Appendix B provides a summary process map of the operating expenditure payment process for the Department.

1.2 Audit Objective

The objective of the audit was to provide assurance that operating expenditure practices related to certification under Section 33 are compliant with relevant legislation.

1.3 Scope

Section 33 is being audited in multiple phases. The first phase of the audit covered all departmental expenditures that were paid using the priority payment method (Phase 1A) and all operating expenditures (Phase 1B). All other expenditures were excluded from Phase 1A and B and will be covered in planned future audits.

Operating expenditures included travel, hospitality, professional services, claims against the Crown, and other operating expenditures including those to other government departments.

The scope of Phase 1B included NHQ, Western-Territories and Quebec. A randomly selected, representative sample of 207 departmental payment transactions processed during fiscal year 2012–13 was reviewed to determine compliance with legislative requirements. The audit fieldwork was completed between July 2013 and September 2013.

1.4 Methodology

The following audit techniques were used:

- Documentation review and analysis of applicable TBS and departmental policies, directives and processes related to Section 33 of the FAA;
- Interviews with management and key individuals within CFOB responsible for Section 33 certification;
- Walkthrough and process observations to identify and assess the design effectiveness of manual and automated key controls; and
- File review of 218 payment transactions - a sample of 207 plus a census of 11 with a high dollar value made during fiscal year 2012–13 to assess the operating effectiveness of key Section 33 controls.

2.0 Audit Findings

2.1 Design of Section 33 Controls is adequate

Roles, responsibilities and accountabilities

Roles, responsibilities and accountabilities for Section 33 are documented in a variety of CFOB guidance documents (e.g. Policy on the Delegation of Financial Signing Authorities and Specimen Signatures, Explanatory Notes – Guide on Delegation of Authority, Delegation of Authority Manual, Policy on Commitment Control, Account Verification and Payment Requisitioning, Payment Instrument Policy). There are also documented desk procedures for financial officers who use the Department's and the Receiver General's systems for authorizing payments under Section 33. However, except for the draft CFOB General Account Verification, National Procedure, no single source fully explains the chain of shared roles and responsibilities for meeting the requirements of the FAA and the Directive on Account Verification.

The audit team was informed through interviews with financial officers and management at NHQ and in the Regions that there is some confusion concerning the control framework for Section 33 and account verification procedures around various payments made by the Department.

Segregation of duties

Documents such as the CFOB Policy on the Delegation of Financial Signing Authorities and Specimen Signatures require a clear segregation of duties over payments. These documents stipulate that one person must not have complete access to, and control over the spending and payment process and that Section 34 and Section 33 functions be kept separate. Interviews and the results of our file reviews confirmed this requirement is met.

Delegation of financial authority instrument

The Department has a Delegation of Authority Manual, explanatory notes, and a chart that show which levels of management have which levels of delegated authority. Authorities are delegated to positions, and there are well-defined procedures for obtaining specimen signatures from the individuals occupying the positions. Images of these signatures are maintained for look-up on the Signing Authority Application (SAA) – an intranet database that contains records on signature cards. The signature cards show the effective date of an incumbent's delegation and, in the case of acting appointments, the effective and end dates of the period of delegated authority.

At present, maintenance of the signature cards and the associated SAA database is not centralized. This has led to observations in past audits of incorrect records of delegated

authority. Plans are to centralize the administration of the cards and database and, eventually, to do away with them entirely and introduce electronic signatures. We encourage management to continue with the timely implementation of these plans to address this weakness.

Statistical Sampling Methodology

The departmental Policy on Commitment Control, Account Verification and Payment Requisitioning as well as the TBS Directive on Account Verification require all high risk transactions to be subjected to a full review of the transaction. These documents allow medium and low risk transactions to be reviewed based on a sampling methodology. Accordingly, the Department has developed a Statistical Sampling Methodology for Account Verification. The methodology was approved by the CFO in January 2012 and made effective April 1, 2012.

The methodology classifies expenditures into risk classes according to a risk management model, and entails different account verification procedures for each class of transaction.

A four-point check is to be performed by financial clerks on all transactions. Clerks are expected to examine Section 34 certifications, accuracy of invoices and payee information and to provide evidence of completing their basic verification steps.

Using the statistical sampling methodology, a sample of low and medium risk transactions are selected post-payment and verified fully on a daily basis by financial analysts. Results of post-payment testing are documented in a tool developed to support detailed account verification.

In addition, a complete verification of all transaction details according to a transaction-specific checklist is to be performed by a financial officer on high risk transactions. High risk transactions include all payments greater than \$275,000 and include select expenditure types such as international travel, travel advances and hospitality expenses greater than \$1,500. Analysts are expected to complete checklists in the sampling tool for each high risk transaction.

The audit noted that the sampling methodology is well designed to support account verification. However, as noted in following sections of the report, the implementation and consistent application of the tool is an area for improvement.

2.2 Implementation of Account Verification Procedures could be strengthened

Account Verification

Detailed procedures and a sampling tool were developed to support the departmental account verification approach. The approach was implemented in NHQ in January 2012, with regional implementation through September 2012. The audit team interviewed individuals responsible for performing account verification. These individuals stated they were uncertain about how to interpret the checklists and how to address errors uncovered using the checklist.

The audit team also observed inconsistencies in the application of the sampling tool:

- Some offices use the sampling tool and detailed verification checklists before releasing high risk transactions from CMS;
- Other offices verify and release high risk transactions from CMS, and then use the tool the next day to record any errors they found and corrected the previous day; and
- Others do not use the tool at all.

A file review of 218 transactions was performed, including a census of 11 high dollar value payments. Despite departmental and TBS requirements that all high risk transactions be subject to a full review prior to payment authorization, we observed 36 out of 184 high risk transactions where the evidence that the payment was pre-verified was not found (i.e. there was no evidence that the tool had been used, or the completed checklist was not on file).

The audit team also tested low and medium risk transactions for evidence of use of a recommended stamp that is initialled by the reviewer, or other annotations signalling the four-point check had been done. We observed eight out of 34 low and medium risk sampled transactions, where there was an absence of evidence of completion of the four-point check.

Recommendation

The CFO should monitor the implementation of the risk based sampling methodology to ensure account verification controls over operating expenditures are consistently applied throughout the Department.

Management Response

CFOB agrees with the recommendation and will ensure that all processing centres apply the sampling methodology and account verification in a consistent approach. The estimated completion date is April 2014.

Risk Management and Quality Assurance

Responsibility for risk management and quality assurance was established in the Integrated Corporate Accounting and Accountability Directorate (ICAAD), within CFOB on April 1, 2012. Staffing was not complete for several months thereafter. Meanwhile, the Department was transitioning to two processing centres for accounts payable – Montreal and Winnipeg – in anticipation of the April 1, 2014 implementation of its new financial management system.

ICAAD stated that it plans to refine the risk management model on an annual basis to reflect the error rates it tracks, but has not so far. A report reflecting the results of applying the statistical sampling methodology in NHQ was produced for the final quarter of 2011-12. A national report for 2012-13 was being finalized as the conduct phase of the audit was being completed. A committee has been established to define a process for developing and approving recommendations for corrective action stemming from the reports produced by the statistical sampling application.

Recommendation

The CFO should ensure the risk management model is updated on a timely basis.

Management Response

The CFOB agrees with the recommendation and will therefore ensure the risk management model is updated on a timely basis. Implementation of the activity is ongoing, yearly cycle to start as of April 1, 2014.

Processing of payment batches

The authorization of payments under Section 33 must be executed by an employee with delegated Section 33 authority. However, it is not effective to have every payment approved individually. Section 33 approval is done daily on a national batch of transactions by a small number of financial officers. In exercising their Section 33 authority, these employees are reliant on the Department's financial control environment.

The adequacy of automated controls over batch processing was tested. The controls were adequate for all transactions included in our audit test. However, the audit team noted there is no audit trail that links individual transactions to payment batches. After significant manual interventions by CFOB at the request of the audit team, individual transactions were linked to specific batches. We consider the lack of a readily available audit trail a control weakness. Furthermore, there is no reconciliation between transactions and approved batches sent to the Receiver General's Standard Payment System. Under these circumstances, there is a risk that unauthorized transactions or duplicate batches may be processed. We were informed that the new financial system has documented audit trails for payment processing.

Recommendation

The CFO should ensure that automated controls over batch processing are documented and tested, including an audit trail linking individual transactions to batches, in the new financial system.

Management Response

CFOB agrees with the recommendation and will therefore ensure that automated controls over batch processing are documented and tested, including an audit trail linking individual transactions to batches, in the new financial system. The estimated completion date is April 2014.

3.0 Conclusion

The audit concluded that operating expenditure payment practices related to certification under Section 33 are compliant with relevant legislation. Improvements to controls over processing of payment batches and risk management practices are recommended to fully implement the control framework.

4.0 Statement of Assurance

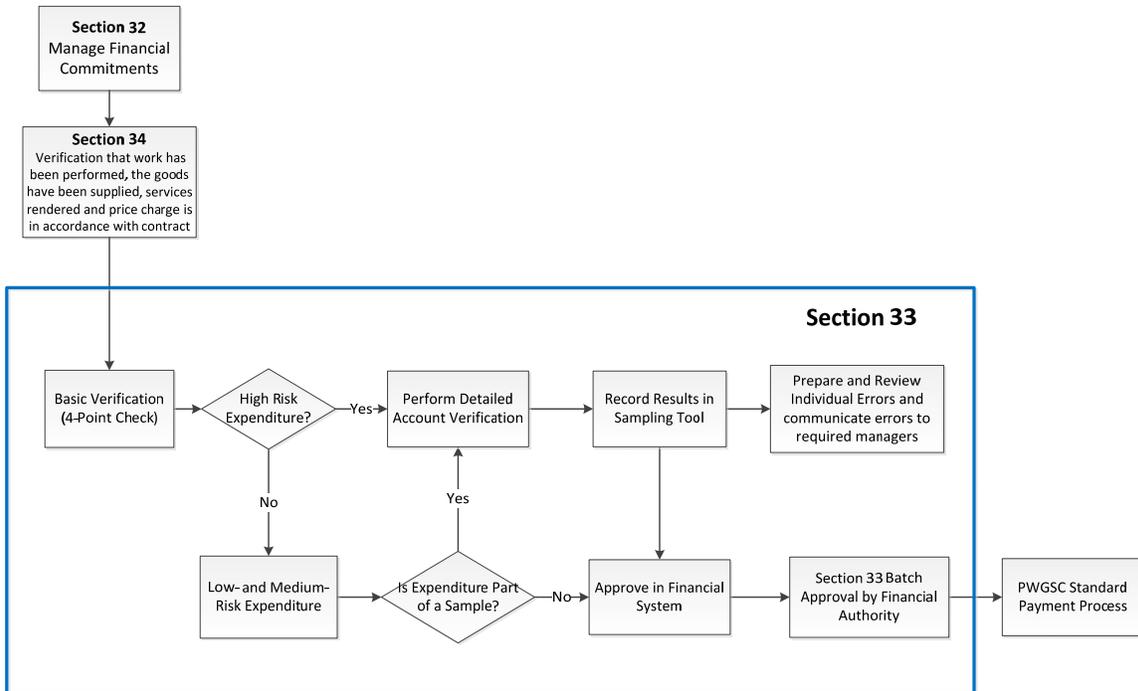
In our professional judgement, sufficient and appropriate audit procedures were performed and evidence gathered to support the accuracy of the conclusions reached and contained in this report. The conclusions were based on observations and analyses at the time of our audit. The conclusions are applicable only for the assessment of operating expenditures payment practices. The evidence was gathered in accordance with the *Internal Auditing Standards for the Government of Canada* and the *International Standards for the Professional Practice of Internal Auditing*.

Appendix A: Audit Criteria Assessment

Audit Criteria	Rating
It is expected that:	
Roles, responsibilities and accountabilities for Section 33 are established and communicated department-wide.	●
Functional advice, guidance and support are provided in a timely and effective manner.	●
A delegation of financial authority instrument is in place and updated as required.	●
Certification under Section 33 is supported by appropriate manual and/or automated application controls.	⊗
There is an account verification process, including a risk management framework, in place, documented, approved, and communicated.	⊗
Appropriate quality assurance processes are in place and support the risk management framework.	⊗
Segregation of duties are appropriate and in accordance with the Directive on Delegation of Financial Authorities for Disbursements.	●

- ⊗ = Best practice
- = Sufficiently controlled, low risk exposure
- ⦿ = Controlled, but should be strengthened, medium risk exposure
- = Missing key controls, high risk exposure

Appendix B: Process Map Section 33 Operating Expenditures



Appendix C: Glossary

CFO	Chief Financial Officer
CFOB	Chief Financial Officer Branch
CMS	Corporate Management System
FAA	<i>Financial Administration Act</i>
ICAAD	Integrated Corporate Accounting and Accountability Directorate
NHQ	National Headquarters
SAA	Signing Authority Application
TBS	Treasury Board of Canada Secretariat